

# Memorandum

TO: DEFERRED COMPENSATION ADVISORY COMMITTEE FROM: Jeanne Groen  
Benefits Manager

SUBJECT: RFP PROCESS FOR INVESTMENT AND ADMINISTRATION SERVICES FOR  
DEFINED CONTRIBUTION PLANS DATE: August 11, 2011

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Approved

Date

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## RECOMMENDATIONS

Staff recommends that the Deferred Compensation Advisory Committee ("DCAC") approve the following:

1. Approve the selection of ING Life Insurance and Annuity Company ("ING") for investment and administrative services for the City of San José, California, Deferred Compensation Plan ("457 Plan") and the City of San José, California, PTC Deferred Compensation Plan ("PTC") with an unbundled fee structure.
2. Direct staff to develop an investment and administrative services agreement with ING for the 457 Plan and PTC Plan to be effective January 1, 2012 through September 30, 2012, with the option to renew in five (5) one-year increments not to exceed a total maximum of 69 months, at a guaranteed cost of 0.09% (9 basis points) of plan assets and return for Committee approval at the October 27, 2011 meeting.

## OUTCOME

Approval of the recommendation will provide the City, its employees and their dependents with high quality and cost effective defined contribution plans.

## EXECUTIVE SUMMARY

Staff facilitated a request for proposal (RFP) process to obtain investment and administrative services for the City's defined contribution plans.

The RFP was a success for the reasons specified below:

- Reduction of administrative fees to participants estimated to save approximately \$525,000 annually, with a total savings over five years of \$2,625,000.
- Reduction of management fees for the stable value fund estimated to save participants approximately \$250,000 annually, with a total savings over five years of \$1,250,000.

In concluding that process, staff is recommending that the DCAC select ING Life Insurance and Annuity Company to provide investment and administrative services to City employees and their dependents effective January 1, 2012.

## **BACKGROUND**

ING has been the investment and administrative services provider of the City's deferred compensation plans since 1982. The current contract with ING expires on September 30, 2012.

The City maintains two Deferred Compensation programs. The City of San José, California, Deferred Compensation Plan ("457 Plan") and the City of San José, California, PTC Deferred Compensation Plan ("PTC"). The 457 Plan is a voluntary plan in which employees may elect to make pre-tax payroll contributions. There is no City matching contribution. The 457 Plan supplements the City's pension plans. As of June 30, 2011, there are 7,111 participant accounts with approximately \$668 million in assets. The second program, the PTC Plan, is a mandatory plan for all employees who are not covered by the City's pension plan (excluding rehired retirees). Contributions to the PTC plan are 3.75% by the City and 3.75% of the participant's earnings. As of June 30, 2011, the PTC Plan has 3,818 accounts with assets totaling \$13 million.

On May 25, 2010, the Deferred Compensation Advisory Committee ("Committee") reviewed the RFP plan issuance plan for investment and administrative services. The Committee provided staff with guidance and input related to the priorities for services, desired qualifications and weighting criteria to be included in the RFP for Investment and Administration Services for Defined Contribution Plans. The Committee directed staff to construct the RFP in a way that sets minimum qualifications so that each proposer could distinguish themselves in each of the rating criterion. The Committee directed staff and the Committee's benefits consultant, Buck Consultants, to include questions in the RFP to obtain information on how a vendor encourages creative and innovative services in the area of participant education and support services, to obtain each vendor's philosophy of approach to target retirement funds, and to capture all related fees.

The Committee established weightings to value the relative importance of the answers related to each of the category of questions as reported in the Evaluation Criteria section of this report. The DCAC approved the RFP timeline, which included up to a year for vendor implementation.

## **ANALYSIS**

### **Evaluation Committee**

The Evaluation Committee for the RFP consisted of Jeanne Groen (Human Resources), Kelly Wright (Human Resources), Maria Oberg (Finance), Ryan Jusko (Retirement), and Jay Wendling (a designated representative for both the Benefits Review Forum and the Association of Retired San José Police Officers and Fire Fighters). Donna Busse (Retirement) replaced Ryan Jusko as he separated from the City during the middle of the RFP process. Jonathan Slinger and Donald Eibsen with Buck Consultants assisted the Evaluation Committee during the review and evaluation process.

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### Targeted Outreach

Buck Consultants, the City's contracted benefits consultant, assisted with the preparation and distribution of the Request for Proposal for Investment and Administration Services on January 26, 2011 with a response due date of March 15, 2011.

The RFP was posted on the BidSync e-Procurement system. Each of the major investment and administration service providers were invited to submit a proposal, including Fidelity, Great-West Retirement Services, Hartford, ICMA-RC, ING, Prudential, TIAA-CREF, T. Rowe Price, VALIC, and Vanguard. On February 9, 2011, questions were received from the prospective respondents. On March 2, 2011, Human Resources staff posted clarification on the BidSync website to the formal questions that were received.

Five vendors, VALIC, Fidelity, T. Rowe Price, Vanguard and PARS, declined to submit a bid. VALIC, Fidelity, T. Rowe Price and Vanguard did not cite reasons for declining. PARS cited that it was unclear from the RFP, addendum, and response to questions from the City whether PARS could bid solely on the mandatory 457 PTC plan. No additional requests for inclusion in the RFP process were received from other bidders.

### Proposals Received

Seven proposals were submitted in response to the RFP. These responses were evaluated by the evaluation committee in March and April 2011. During the initial evaluation, the Evaluation Committee ranked the written proposals based on the Committee's previously established criteria. This ranking identified the top three finalists as Great-West Retirement Services, ICMA-RC, and ING.

All respondents who were eliminated had weaknesses in their proposals, as compared to the selected finalists, in at least one of the four major criteria categories of vendor qualifications; participant education and support services; administration recordkeeping and custodial; stable value; and investments and fees. By contrast, the finalists provided better investment and administrative services combinations, lower fees, and more comprehensive recordkeeping and educational services. All proposals offered the ability to select non-proprietary investment options which gives the Committee flexibility to select a customized investment menu.

The Evaluation Committee identified key issues with each of the three finalists and held finalist interviews on June 28, 2011 to address outstanding issues, seek clarifications, and solicit final-best proposal modifications from each finalist. The finalists were further evaluated on the previously established criteria. Per Municipal Code requirements, the finalists' proposals were also reviewed to determine if they qualified for the local and/or small business preference.

### Evaluation Criteria

The RFP was structured to mirror the following selection criteria developed by the Deferred Compensation Advisory Committee. It was the intent of the selection committee to choose the most qualified service provider based on these selection criteria and weights:

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- Vendor Qualifications (10%)
- Participant Education and Support Services (10%)
- Administration, Recordkeeping and Custodial (10%)
- Stable value (30%)
- Investments and Fees (30%)
- Local Business (5%)
- Small Business (5%)

Initial Evaluation and Elimination

The Evaluation Committee reviewed all proposals received based on the stated RFP requirements for investment and administration services for defined contribution plans.

All proposals received met the RFP's stated vendor qualifications, which includes the history of the firm, experience with similar size plans, references, relationship manager, transition timeline, credit rating, and fiduciary status.

The Review Committee evaluated the proposals received for investment and administration services for defined contribution plans. The proposals submitted by four providers, Hartford, Prudential, TIAA-CREF, and Wells Fargo were eliminated from further consideration for the following reasons:

1. Hartford's proposed fees were higher than the selected finalists. Hartford's proposal was also eliminated due to the lack of information provided regarding the stable value fund. Specifically, Hartford did not address the market-to-book value issue in the proposal. Lastly, it is not clear what Hartford is proposing with respect to the custom lifestyle portfolios, a portion of which is invested in stable value.
2. Prudential's proposed fees were higher than the selected finalists. Prudential's proposal did not indicate that they would agree to as many performance guarantees as compared to the other vendors. Prudential did not provide a stable value option and did not specify how the stable value component of the custom lifestyle portfolios would be handled.
3. TIAA-CREF's proposed fees were higher than the selected finalists. TIAA-CREF's proposal responses demonstrated a preference for offering decentralized account support. TIAA-CREF's stable value fund appears to be a new product, with a smaller asset base and shorter performance history. The additional annual fees of 0.38% to amortize market-to-book difference over five years would be significant and were judged to not be in the best interest of the plan and plan participants. TIAA-CREF proposal did not offer a plan level newsletter. TIAA-CREF's proposal was also eliminated due to incomplete responses to many questions.
4. Wells Fargo's proposed fees were higher than the selected finalists. Wells Fargo's proposal was also eliminated due to incomplete information related to the number of transition meetings that would be needed. In addition, Wells Fargo did not include sample plan newsletters as an appendix to the proposal. Wells Fargo's proposed stable

value fund would require a negative market value adjustment to use in the short-term. Wells Fargo's proposal lacked a transition plan.

This initial RFP proposal evaluation resulted in identifying Great-West, ICMA-RC and ING as the finalists to be interviewed by the Evaluation Committee. The interview consisted of questions to clarify RFP responses and a general overview presentation from each proposer. Following the interview, additional information was required by the Evaluation to further assess Stable Value Fund Options and fee structures.

#### Stable Value Fund (SVF) Options

With the assistance of Buck Consultants, the Evaluation Committee reviewed the advantages and disadvantages of Stable Value Fund (SVF) alternatives provided in each of the finalist's proposal. A summary of this analysis is provided below.

##### *ING SVF Advantages:*

The existing Stabilizer Contract or "wrap contract" provides the City with a "book value settlement" phase option which would allow the City to terminate the Stabilizer Contract and receive full book value for participants. The City's consultant has not recommended this course of action to correct the current market to book value difference, but it is one option available if the market to book value ratio were to deteriorate significantly. Given that the SVF's current market to book value ratio is below 100%, it is difficult to enter into a new contract with a different provider that will offer this important feature to the City's SVF.

##### *ING SVF Disadvantages:*

The ING Stable Value fund has underperformed its benchmark since its inception in 2006. In 2009, ING Investment Management made significant changes to the structure and leadership of its fixed income team responsible for managing the SVF. The ING SVF has performed well relative to its benchmark since this management restructuring occurred in 2009. Buck Consultants has a favorable view of the group's new leadership.

##### *Great-West SVF Advantages:*

Great-West proposed transitioning assets from the current ING stable value fund over to management by Great-West as soon as is practicable, and suggested that the City might make this transition prior to the full implementation of Great-West's recordkeeping services if they were selected as the successful bidder. Great-West has transitioned stable value separate accounts from other public entities in the recent past, including other clients based in Northern California. Great-West would allow the City of San José flexibility to construct a customized investment policy which would specify target allocations to different bond market sectors, credit quality guidelines, as well as interest rate risk guidelines (duration). Great-West's SVF manager has a long tenure with the firm, has achieved attractive performance results over time, and is viewed highly by Great-West's references.

##### *Great-West SVF Disadvantages:*

If the City transitioned to Great-West SVF, the City's SVF would no longer have a "book value settlement" option available to it in the event that the market to book value ratio of the stable value fund deteriorated significantly.

*ICMA-RC SVF Advantages:*

ICMA-RC included a proprietary stable value fund (the Plus Fund) in its proposal and also noted that the City would have full flexibility to select a non-proprietary stable value fund under the terms of its proposal.

*ICMA-RC SVF Disadvantages:*

ICMA-RC's proposed proprietary SVF is a commingled vehicle that would be difficult for the City to use in the short-term. Because the current market to book value ratio of the ING SVF is below 100%, an immediate transition to the ICMA-RC product would result in a negative market value adjustment for participants. Buck advised, and the Evaluation Committee agreed, that this course of action would not be in the best interest of the plan or plan participants.

ING Stable Value Fund Recommendation

In light of the market to book value ratio and current book value settlement provision, Buck advised, and the Evaluation Committee agreed, that transitioning the SVF to either Great-West or ICMA-RC would not be in the best interest of the plan or plan participants. In the near term, it is in the City's best interest to retain the ING SVF with the current Stabilizer Contract. This recommendation does not, however, require the City to select ING as the record keeper for the 457(b) plan.

The finalists were asked to submit their revenue sharing requirements (administration pricing) under an "unbundled" scenario. Unbundling means that the Committee will select a record keeper which will permit the City flexibility in choosing a non-proprietary SVF. For example, if ING is selected under an unbundled fee structure, the City would have flexibility in selecting a non-ING SVF at some point in the future. If a vendor other than ING is selected under an unbundled fee structure, the City would have the flexibility to retain the current ING SVF in the near term while preserving the option to select a non-ING SVF at some point in the future.

Both Great-West and ICMA-RC were asked to confirm if they would be able to administer the ING SVF if selected as record keeper. Additionally, all finalists were asked to provide an updated revenue sharing amount (pricing) under an unbundled fee structure.

Bundled, Partially Bundled and Unbundled Fee Structure Analysis

To evaluate the fees for each of the remaining finalists, Great-West, ICMA-RC and ING, the Evaluation Committee considered the fee impact under a bundled, partially bundled or unbundled fee structure. Fees were compared for each of these options:

- A. **Bundled Fee Structure** – The City would use the selected vendor's proprietary stable value fund and proprietary target date fund series, but there would be no proprietary product requirements for the plan's other investments.

Current Fee	Great-West	ICMA-RC	ING
0.17%	0.00%	0.092%	0.08%

- B. Partially Bundled Fee Structure** – The City would use the selected vendor's proprietary stable value fund (SVF) or proprietary target date fund (TDF) series, but not both. There would be no additional proprietary product requirements for the plan's other investments.

Current Fee	Great-West SVF Only	Great-West TDF Only	ICMA-RC	ING SVF Only	ING TDF Only
0.017%	0.035%	0.08%	0.092%	0.08%	0.09%

- C. Unbundled Fee Structure** - Under an unbundled scenario there would be no proprietary product requirements for the plan's other investments. This structure provides a fiduciary the ability to select the best investment option at the time of selection and eliminates the possibility of selecting an investment option for recordkeeping discounts. The Committee would have the flexibility to select non-proprietary investment products in every category including stable value and target date funds.

Current Fee	Great-West	ICMA-RC	ING
0.17%	0.11%	0.092%	0.09%

For all options above, any revenue sharing generated in excess of the requirements shown on the table above would be returned to the City to offset internal administrative expenses. The current investment line-up generates revenue sharing in excess of the current 0.17% fee requirement in an amount sufficient to provide a revenue sharing reimbursement to the City to offset internal administration expenses. If the 0.17% requirement was reduced to 0.09%, the plan would generate substantially more revenue sharing than would be needed. After a new vendor is selected, staff will need to work with Buck Consultants to develop recommendations, such as ways to modify the investment menu so that the plan will generate a lower level of revenue sharing.

In the options above, Great-West offered the largest discounts for bundled investment product with administration, but has a higher revenue sharing requirement in an unbundled structure. Great-West's proposal for bundled services included a reduction in fee by one basis point if Great-West did not need to offer a local office.

ICMA-RC offered a consistent fee, regardless of whether bundled, partially bundled or bundled fee structure.

ING offered a slight reduction in fees for the bundled fee structure. ING has the lowest revenue sharing requirement under an unbundled fee structure.

After considering the options and associated fees, the Evaluation Committee recommends the unbundled fee structure. The unbundled fee structure would provide the City full flexibility in selecting non-proprietary investment options, and this flexibility would extend to target date and stable value products. Additionally, this structure provides a fiduciary the ability to select the best investment option at the time of selection and eliminates the concern that an investment option may have been selected based on recordkeeping discounts. The estimated annual savings of the unbundled fee structure would reduce fees from 0.17% to 0.09%. Based on current enrollment and asset value, the savings is estimated to be \$525,000 annually.

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Managed Account Fees

During the finalist interviews, it was determined that vendors also receive fees for any participants who enroll in a managed accounts option. These fees are in addition to the administrative fees outlined above. While enrollment in managed accounts is an option, and all vendors would permit the City to determine whether managed accounts was made available to participants, the Evaluation Committee felt it was important to assess these fees as well. A vendor's representative would be required to explain the fees to the member. However, it would be difficult for a participant to evaluate if the fees were reasonable, and hence are part of the evaluation of costs.

The chart below includes City of San José participant account balances as of 6/30/11.

<b>Amount (\$)</b>	<b>Number of Participants</b>
Up to 5,000	775
5,001 – 25,000	1,692
25,001 – 50,000	1,140
50,001 – 100,000	1,211
100,001 – 200,000	1,290
200,001 – 300,000	635
300,001 – 400,000	249
400,001 – 500,000	72
500,000 and above	47
<b>Total Accounts</b>	<b>7,111</b>

Below are the proposed managed account fees for each of the finalists.

**Great-West**

<b>Participant Account Balance</b>	<b>Managed Account Fee</b>
First \$100,000	0.60%
Next \$100,000 to \$250,000	0.50%
Next \$250,000 to \$400,000	0.40%
Amounts over \$400,000	0.30%

**ICMA-RC**

<b>Participant Account Balance</b>	<b>Managed Account Fee</b>
First \$25,000	0.60%
Next \$25,000	0.55%
Next \$50,000	0.45%
Next \$150,000	0.35%
Over \$250,000	0.25%



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**ING**

<b>Participant Account Balance</b>	<b>Managed Account Fee</b>
All balances	0.35%

The Evaluation Committee also asked each vendor to estimate the expected participation in managed accounts based on current books of business. Below were the vendors' responses:

<b>Participation in Managed Accounts</b>	<b>Current Participation</b>	<b>Great-West</b>	<b>ICMA-RC</b>	<b>ING</b>
<b>% in Book of Business</b>	N/A	9%	4%	2% - 5%
<b>% Expected at the City</b>	2%	9%	4%	1% - 3%

Annual Dollar Managed Account Fees

The following table estimates the annual Managed Account Fees based on actual participation.

	<b>Annual fee for \$100,000 Balance</b>	<b>Annual fee for \$250,000 Balance</b>	<b>Annual fee for \$500,000 Balance</b>
Great-West	\$600	\$1,350	\$2,250
ICMA-RC	\$513	\$1,037	\$1,663
ING	\$350	\$875	\$1,750

Based on actual participation, ING's fees overall are better suited for the deferred compensation plan. ING for managed account fees would result in a lower fee for the majority of plan participants. Relative to the other finalist proposals submitted by ICMA-RC and Great-West, ING's fee structure is most likely to result in a lower cost as participation in managed accounts is less likely, when you compare vendor's typical participation overall. Additionally, ING proposed a flat fee of 0.35% that will remain the same for all participants, regardless of account balance. The proposed fee of 0.35% matches the managed account fee currently paid by participants.

Reference Checks

Reference checks were completed for the finalists, ICMA-RC, ING, and Great-West. Based on the feedback received during the reference check process, the general trends for three finalists include providing excellent products, services, and customer service. The reference checks also included feedback that the three finalists have the capability to provide sufficient recordkeeping services. There was a theme regarding ING's financial representatives for their strong knowledge, background, and education.

## **FINAL EVALUATION RESULTS**

Each of the three finalists (ING, ICMA-RC, and Great-West) provided the best and most complete information to demonstrate their qualifications and capability to provide investment and administration services for the Deferred Compensation Plans.

Below is a summary of the scores assigned to each finalist based on the defined RFP criteria. These are the scores on which the Evaluation Committee based its recommendation. The Evaluation Committee rated the finalists on a scale of 1.0 to 5.0 (5.0 being the highest rating) based on the defined RFP evaluation criteria and weights.

CRITERIA AND WEIGHTING	Evaluation Committee Averages		
	GREAT WEST	ICMA-RC	ING
Vendor Qualifications (10%)	4.5	4.3	4.4
Participant Education & Support Services (10%)	4.1	4.2	4.6
Administration, Recordkeeping & Custodial (10%)	4.3	4.3	4.5
Stable Value (30%)	3.5	3.5	3.8
Investments & Fees (30%)	3.7	4.3	4.4
Local Business (5% each)	0.0	5.0	5.0
Small Business (5% each)	0.0	0.0	0.0
<b>Total Weighted Score</b>	<b>3.4</b>	<b>3.9</b>	<b>4.1</b>

### **The ING Recommendation**

The Evaluation Committee made the decision to recommend ING based on the submitted RFP and finalist interviews and responses to the Evaluation Committee's questions. ING also agreed to an early implementation of the reduced administrative fees. As a result, the Evaluation Committee recommends that the implementation date of the contract be accelerated to January 1, 2012.

- ING is being recommended to the Committee among the finalists (Great-West Retirement Services and ICMA-RC) based on the following key comparisons:
  - ING's proposal for investment and fees resulted in the lowest revenue sharing requirement at 0.09% (or 9 basis points) under an unbundled fee structure;
  - ING's financial representatives demonstrate a strong knowledge base regarding the Deferred Compensation program;
  - ING provided a proposal that included a local office that is convenient to the City of San José employees;
  - ING's managed accounts and participant advice services reflected lower fees (0.35% annual fee with promotional 90-day fee waiver option);
  - ING's proposal reflects significant improvements to the Easier Administrative Solutions for Everyone (EASE) recordkeeping platform to include reporting tools for plan sponsors and participants;

- ING's stable value proposal included: reducing total fees associated with the account from 0.80% to 0.47%; the City would retain a "book value settlement" option within the existing wrap contract; the City would be able to use the money market fund alongside stable value fund; and the City would have the flexibility to use a non-proprietary stable value fund; and
  - ING qualified as a Local Business Enterprise.
- ICMA-RC is not being recommended for the following reasons:
  - ICMA's proposed administration fees under all scenarios were slightly higher than the fees proposed by ING, who is the incumbent provider
  - ICMA's proposed local office was viewed to be slightly less convenient for City employees
- Great-West is not being recommended for the following reasons:
  - Great-West's proposal offered the largest discounts for the bundling investment product with administration; however, there is a higher revenue sharing requirement under an unbundled fee structure
  - Great-West's proposal did not qualify as a Local Business Enterprise and/or Small Business Enterprise
  - Great-West's proposed administration fees under an unbundled scenario were higher than the other two finalists
  - Reference checks indicated that Great-West's on-site representatives were not viewed as highly as those employed by the other two finalists by other public sector plan sponsors
  - Great-West proposed managed account fees were higher for the majority of participants than the other two finalists

If the DCAC approves the Evaluation Committee's recommendations, the next steps in the RFP process include the following:

- Negotiate the final agreements with ING for the 457 Plan and PTC Plan to be effective January 1, 2012;
- Implement the reduced administrative fees effective January 1, 2012
  - Implementation would include making changes to the investment menu to reflect the lower administration fee requirement while still providing the City with adequate reimbursement to offset internal administration expenses; and
- Initiate a plan to implement the Roth 457 option effective January 1, 2012 or as soon as administratively feasible thereafter.

### **EMPLOYEE NOTIFICATION OF RECOMMENDATION**

Upon public posting of this report, staff will provide a copy of this recommendation to OER and the Benefits Review Forum to permit labor representatives an opportunity to comment on the vendor selection at the August 25, 2011 meeting. Additionally, at the direction of the Committee Chairman, Peter Jensen, staff has notified participants of this recommendation via a direct mailing. In the direct participant mailing, participants were provided a direct website link to

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obtain this recommendation report. Participants invited to send their written comments to staff via mail or email and were invited to attend the Deferred Compensation Advisory Committee's meeting on August 25, 2011.

**EVALUATION AND FOLLOW-UP**

This project addresses the Human Resources' performance measure of the cost of benefits administration and operations per budgeted full-time employee. The Employee Benefits division of Human Resources ensures that the City of San José employees and retirees receive high quality and cost effective benefits by subjecting benefit plan providers to regular competitive processes (usually every four years).

**COORDINATION**

The selection process and these recommendations will be coordinated with the City Managers Office, Human Resources Office, Office of Employee Relations, City Attorney's Office, Finance and Retirement Department.

**COST SUMMARY/IMPLICATIONS**

These recommendations will not result in any additional cost to the Deferred Compensation program. As is currently the case, all of the plan's administrative expenses will be reimbursed by the provider from the participants collected fees. All other expenses are related to the investment options selected by participants, and while those expenses will continue to be borne by the participants, the expenses will be reduced as a result of these recommendations.

  
Jeanne Groen  
Benefits Manager